

This letter provides a ruling on whether a specific purchase of an aircraft qualifies as a occasional sale. See 35 ILCS 105/2. (This is a PLR).

October 5, 2000

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>), is in response to your letter of September 26, 2000. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the enclosed copy of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

I request a private letter ruling for **COMPANY**. My Power of Attorney is attached.

This matter is not under audit or in litigation. The Department has not previously ruled on the same or a similar issue nor has a similar ruling request been submitted but withdrawn prior to the issuance of a ruling. I am unaware of any authority contrary to the position stated in this request.

COMPANY ("Proposed Buyer") will be a limited liability company formed to acquire and operate an airplane known as a ### ("the Aircraft"). Proposed Buyer will, at the conclusion of the transaction, have a single member. That member will be BUSINESS now an Illinois sub-S corporation located at ADDRESS. I request a ruling that the use of the Aircraft in Illinois, assuming that it is acquired under the facts described herein, will be exempt from Illinois and local use tax on the ground that it was acquired in a transaction qualifying as an isolated or occasional sale.

The Proposed Seller

The Aircraft is now operated by **PERSONS** who are residents of **PLACE** (hereafter referred to as "Proposed Seller"). The Proposed Seller has rights in the Aircraft from the Aircraft Lease dated **DATE** between the Proposed Seller and **AAA** ("Finance Corporation") ("Airplane Lease"). A copy of the Airplane Lease, as amended, is appended to the enclosed affidavit of **PERSON** of Finance Corporation. Finance Corporation is the finance arm of BBB, a manufacturer and seller of airplanes. The Proposed Seller has operated the Aircraft for business and personal purposes since DATE. The Proposed Seller is not in the business of selling airplanes.

The Aircraft currently has a Federal Aviation Administration Certificate of Registration showing Finance Corporation as the operator. The FAA Registry of Title shows Finance Corporation as the owner.

The Aircraft Lease is for a term of 128 months. Paragraph 5 provides the Proposed Seller with an option to purchase on the date that any monthly rental payment is due or on the last day of the term of the lease. The option price is the "stipulated loss value" as set forth on Revised Annex C to the lease agreement.

The Aircraft Lease states that the original purchase price of the Aircraft was \$16,554,000.68. Under Revised Annex C to the Aircraft Lease, the stipulated loss value is now approximately \$9,435,452. On the last day of the lease term, the stipulated loss value is \$1,925,450. The affidavit explains that the amount of the stipulated loss value at the end of the lease term and the provision that the Aircraft will be registered in the United States were the result of the negotiation process between Finance Corporation and the Proposed Seller.

The enclosed affidavit states that Finance Corporation does not depreciate the Aircraft on its federal income tax return. In other words, Finance Corporation files income tax returns on the basis that Finance Corporation does not own the airplane, but has made a loan to the Proposed Seller. The affidavit also states that Finance Corporation would have established a residual value for the aircraft at the end of the 128-month term as 61% of the original purchase price. The Aircraft's value at the end of the term would thus have been estimated as \$10,097,940. The proposed transaction between Proposed Seller and Proposed Buyer calls for the Proposed Buyer to purchase the Aircraft for \$16,000,000. The Proposed Seller would exercise its purchase option with Finance Corporation and then transfer the Aircraft to the Proposed Seller.

The Proposed Buyer

The Proposed Buyer will be a limited liability company. When the Proposed Buyer acquires the Aircraft, the sole member of the LLC will be a **CCC** subsidiary that is in the business of acting as an intermediary in like-kind exchanges. ("Bank"). Bank will subsequently transfer its interest in the LLC to **BUSINESS**. The reason for the transfer of the membership interest is as follows.

BUSINESS is an Illinois subchapter S Corporation. **BUSINESS** now owns a second airplane, known as a **NAME** ("the second Aircraft").

BUSINESS intends to sell the second Aircraft. It does not now have a buyer for the second Aircraft. **BUSINESS** anticipates that it will be able to sell the second Aircraft for an amount in excess of its basis in the second Aircraft. **BUSINESS** intends to defer recognition of this gain for income tax purposes by using the deferred exchange mechanism afforded by Internal Revenue Code §1031.

Section 1031 provides that a taxpayer may defer recognition of gain on the disposition of an asset used in its trade or business where the asset is exchanged for another asset of like kind. It is common for the owner of the new like-kind asset that the taxpayer wishes to acquire ("the replacement property") to be unwilling to engage in a direct exchange of the replacement property for the property the taxpayer intends to give up ("the relinquished property"). Section 1031 thus provides for three-party exchanges where the taxpayer sells the relinquished property to a third party and uses the proceeds to purchase the replacement property. Section 1031 allows the sale of the relinquished property to take place before or after the purchase of the replacement property. The taxpayer will not qualify for the deferral of gain if it owns the relinquished property, or the proceeds from the sale of the relinquished property, at the same time that it owns the replacement property.

Section 1031 and the applicable regulations permit the taxpayer to use a Qualified Intermediary to facilitate the deferred exchange. The Qualified Intermediary may acquire the relinquished property from the taxpayer, sell it to a third party and hold the proceeds for a period of time during which the taxpayer seeks to identify the replacement property. An IRS Revenue Procedure also allows a reverse exchange in which the Qualified Intermediary acquires and holds the replacement property for the taxpayer while the taxpayer locates a buyer for the relinquished property. Once the taxpayer locates a buyer for the relinquished property, it effects the sale of the relinquished property through the Qualified Intermediary, thus completing the exchange.

The Proposed Transaction

Under the proposed transaction, the Proposed Buyer would be established as a limited liability company with Bank as its sole member. Bank would be acting as a Qualified Intermediary for **BUSINESS** under a trust agreement. **BUSINESS** would loan to the Proposed Buyer the \$16 million needed to purchase the Aircraft. The Proposed Buyer would deposit the \$16 million purchase price in an escrow. The Proposed Seller and the Proposed Buyer would direct the escrow to pay the amount required by the purchase option to Finance Corp. Finance Corp. would issue a FAA bill of sale to Proposed Seller. Proposed Seller would in turn issue a FAA bill of sale to Proposed Buyer. The FAA will not issue a Certificate of Registration to the Proposed Seller because it is not a United States citizen lawfully admitted for permanent residence in the United States. The Proposed Seller would thus not apply to the FAA for a Certificate of Registration. The Proposed Buyer would apply for a FAA Certificate of Registration after closing. The FAA Registry of Title would show title passing from Finance Corp. to the Proposed Seller and from the Proposed Seller to the Proposed Buyer.

The Proposed Buyer would proceed to lease the Aircraft to **BUSINESS**. **BUSINESS** would be responsible for all expenses of operation of the Aircraft during the lease period.

Once **BUSINESS** locates a buyer for the second Aircraft, it would sell the second Aircraft through the Proposed Buyer. After the closing of the sale to the second Aircraft,

Bank would assign its interest in the Proposed Buyer to **BUSINESS**. There would be no transfer of title or registration of the Aircraft which would be continued to be owned by the Proposed Buyer.

Requested Ruling

I request your determination that the transaction described will qualify for the isolated or occasional sale exemption. The rationale for this conclusion is as follows.

The Proposed Seller should now be considered to be the owner of the Aircraft and not to be a lessee. The Proposed Seller is the owner if the Aircraft Lease is a contract for a conditional sale rather than a lease. The Department's position has been that an agreement under which the transferor retains title to tangible personal property and transfers possession to the transferee is a conditional sale if the transferee makes periodic payments such that, after the last payment called for by the lease, the transferee will acquire title to the tangible personal property for no additional consideration or for a nominal additional consideration. The Department has also concluded that a conditional sale exists where the transferor is assured that, at the end of the scheduled payments, the transferee will purchase the tangible personal property. This would be the case where the transferee may purchase the tangible personal property for an amount significantly below the fair market value.

The Proposed Seller's agreement with the Finance Corporation embodied in the Aircraft Lease is a conditional sale. The Proposed Buyer has agreed to purchase the Aircraft for \$16,000,000. The contemplated purchase by the Proposed Buyer is an arm's length transaction and the \$16 million price thus represents the current fair market value. The Proposed Seller has the ability to now purchase the Aircraft for about \$9,435,452 (plus other back payments owed under the agreement.) The Proposed Seller thus has the ability to acquire the aircraft for 58% of its current fair market value. This clearly would be a purchase for an amount far below the current fair market value.

Additionally, the Aircraft Lease gave the Proposed Buyer the ability to purchase the Aircraft at the end of the term for \$1,925,450. Since Finance Corporation states that the fair market value of the Aircraft at the end of the Lease, as it would have been determined in September, 1998, would have been \$10,097,940. Proposed Buyer would have been economically compelled to purchase the aircraft at the end of the lease term. It would be irrational to not purchase an asset that is worth over \$8,000,000 more than the purchase price.

If the Aircraft Lease is a conditional sale, then the Proposed Seller is the current owner of the Aircraft. The Proposed Seller became the owner two years ago and has used it as part of his business. Assuming he is not in the business of selling Aircraft, then his sale of the Aircraft to Proposed Buyer would be an isolated or occasional sale.

The FAA Registry of Title will show a transfer of ownership from Finance Corporation to Proposed Seller and a subsequent, although nearly simultaneous, transfer from the

Proposed Seller to the Proposed Buyer. The Proposed Seller will not receive a FAA Certificate of Registration. However, the issuance of the Certificate of Registration is not necessary for ownership to vest in the Proposed Seller.

After **BUSINESS** completes the sale of the second Aircraft through the qualified intermediary, Bank will transfer its membership interest in the Proposed Buyer to **BUSINESS**. At that point, the Proposed Buyer will be the owner of record of the Aircraft, as shown on the FAA Registry of Title. The transfer of the membership interest in the limited liability company will not constitute a sale of tangible personal property. The contemplated transfer should have no impact on the Proposed Buyer's ability to qualify for the isolated or occasional sale exemption.

State of STATE)
) ss:
County of COUNTY)

AFFIDAVIT

PERSON, being first duly sworn on oath, deposes and states:

1. I am TITLE. My duties include negotiating leases of new and used airplanes.
2. I am familiar with the aircraft lease dated DATE, between AAA and PERSONS (jointly and severally, "Lessee"), a copy of which is attached as Exhibit A to this Affidavit (the "Lease"), and with the two amendments thereto (the "Amendments") which are attached as Exhibits B and C, respectively, to this Affidavit. The Lease and the Amendments cover a #####, U.S. Registration Number ##### (the "Aircraft").
3. CCC does not claim depreciation expense on the Aircraft.
4. The Lease, as amended, gives the Lessee the option to purchase the Aircraft at this time for approximately \$11,872,585.11. In my opinion, the fair market value of the Aircraft is currently \$16,000,000.
5. As of DATE, when the Lease was executed, CCC would have estimated that the Aircraft would have a residual value equal to or greater than 61% of the original selling price or \$10,098,306 on the last day of the 128 month term of the Lease.
6. The Lease and the Amendments establish a stipulated loss value on the last day of the 128 month term of the Lease of \$1,825,450. Pursuant to Article 5 of the Lease, Lessee has the option to purchase the Aircraft for this amount, plus any other sums then due under the Lease, on the last day of the term of the Lease. This stipulated loss value figure and the provisions of the Lease requiring the Aircraft to be registered in the United States were the result of negotiations between CCC and Lessee. CCC prefers

to have the Aircraft registered in the United States in CCC's name rather than in PLACE and it is presently so registered. I have read 49 U.S.C. 1401 and 14 C.F.R., Section 47.3, which indicate to me that two individuals who are not citizens of the United States cannot legally register an aircraft in the United States unless they are individual citizens of a foreign country who have lawfully been admitted for permanent residence in the United States. To the best of my knowledge, PERSONS have not been so admitted for permanent residence in the United States.

FURTHER AFFIANT SAYETH NOT.

PERSON

DEPARTMENT OF REVENUE RESPONSE

The first issue raised in this transaction is whether the aircraft lease, between AAA and PERSONS is a true lease or conditional sales contract for Illinois Retailers' Occupation Tax and Use Tax purposes. A conditional sale is usually characterized by a nominal purchase option at the close of the lease term. Stated otherwise, if a lessor is virtually certain at the time of the lease that the purchase option will be exercised by the lessee, that transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax. See subsection (a) of the enclosed copy of 86 Ill. Adm. Code 130.2010. A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease.

The information contained in your letter and the attached documentation provides that the purchase provision in the "aircraft lease" is for an amount not less than 11% of the total aircraft price. Revised Annex C to the Aircraft Lease provides that the Total Aircraft Price is \$16,554,600. We have calculated that the purchase option is for an amount of not less than \$1,821,006.¹ On its face, this amount does not appear to result in a nominal purchase option. However, the affidavit of PERSON, for AAA, dated DATE, that was attached to your letter ruling request states that "[a]s DATE, when the Lease was executed, CCC [AAA] would have estimated that the Aircraft would have a residual value equal to or greater than 61% of the original selling price or \$10,098,306 on the last day of the 128 month term of the Lease." Thus, under the terms of the transaction set out in your letter, the purchase option authorizes the lessee to purchase the aircraft with an estimated fair market value of at least \$10,098,306 for \$1,825,451.² Because of these terms, we are required to conclude that the purchase option makes the transaction a conditional sales contract.

Therefore, PERSONS would be considered the owners of the aircraft, and based upon the assertion in your letter ruling request that PERSONS are not in the business of selling aircraft, the sale of the aircraft by PERSONS would qualify as an isolated or occasional sale. The purchaser, COMPANY, would then incur no Illinois Use Tax liability on the purchase of the aircraft because the transaction is an isolated or occasional sale.³

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The second issue is the lack of PERSONS being shown on the FAA Certificate of Registration. Your letter states that the FAA will not issue a Certificate of Registration to foreign nationals. Therefore, the fact that the FAA will not issue a Certificate of Registration to PERSONS because they are foreign nationals is not determinative as to whether PERSONS are recognized as the owners of the aircraft.

Your letter states that AAA will issue a FAA bill of sale for the aircraft to PERSONS, and PERSONS will in turn issue a FAA bill of sale for the aircraft to COMPANY. We believe that the ownership evidenced by these FAA bills of sale is determinative as to who the owners and purchasers of the aircraft are the time of those sales. This determination of ownership would be supported by the FAA Registry of Title showing title passing from AAA to PERSONS and from PERSONS to COMPANY.

The remaining issue is the effect of the transfer of the ownership interest in COMPANY from a CCC subsidiary to BUSINESS, an Illinois subchapter S Corporation. Your letter states that, although the ownership interest in COMPANY would be transferred, there would be no transfer of title or registration of the aircraft and the aircraft would continue to be owned by COMPANY. Based upon these representations, we do not believe that the transfer of the ownership interest in COMPANY would have any impact on whether the purchase of the aircraft by COMPANY qualifies as an isolated or occasional sale.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. In this instance, we view the material facts as including, but not limited to: (1) the purchase option in the amount of \$1,825,451 was intended to be a nominal purchase option and the estimated fair market value of the aircraft, as determined at the time of execution of the Aircraft Lease, was at least \$10,098,306; (2) AAA will issue a FAA bill of sale for the aircraft to PERSONS; (3) PERSONS will issue a FAA bill of sale for the aircraft to COMPANY; and (4) the FAA Registry of Title will show title passing from AAA to PERSONS and from PERSONS to COMPANY. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have questions regarding this Private Letter Ruling you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.

¹ Revised Annex C to the Aircraft Lease provides that the Stipulated Loss Value on the last day of the term of the Lease is \$1,825,451. The letter ruling request states that the stipulated loss value at the end of the term of the lease is \$1,925,450. We understand that the \$1,925,450 amount actually represents the Stipulated Loss Value of \$1,825,451 plus the last monthly payment of \$86,370 as shown on the Revised Annex D to the Aircraft Lease.

² The buyer, COMPANY, is purchasing the aircraft for \$16,000,000 which supports the finding that the purchase option is for a nominal amount. We have also noted other facts that are consistent with the Aircraft Lease being intended as a conditional sales contract rather than a true lease. The lease payments shown on the Revised Annex D to the Aircraft Lease vary wildly from month to month with no recognizable pattern. You have informed us by telephone that these payment amounts were negotiated in response to the purchasers' cash flow situation. In addition, PERSON's Affidavit states that AAA does not claim depreciation expense on the aircraft.

³ See 35 ILCS 105/2.